Petition

81-1088

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No. 81-

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

EMI LIMITED,
Plaintiff, Appellant and Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., SUCCESSOR; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Defendants and Appellees.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals for the Ninth Circuit Prior to Entry of Decision in That Court and While Case Is Pending Therein

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QUESTIONS PRESENTED

1. Whether Section 1341, Title 28, United States Code, removes from the federal court's jurisdiction a suit to enjoin and restrain the assessment and collection of a California Franchise tax, where the complainant has no judicial remedies available to it in the California courts, either by way of refund, or suit for injunction or to restrain the assessment and collection of the tax, or of any other nature. It is not contended that this issue is the one which justifies intervention of this Court prior to decision in the Court of Appeals under the standards explained in Rule 18 of the Rules of this Court.

2. May the State of California burden foreign commerce by extending the combined unitary income formula (hereinafter "combined formula") which it has adopted for tax purposes to a United Kingdom corporation which has foreign commerce with the United States but which does no business in any state of the United States, which does not have a permanent establishment in the United States, which is not subject to taxation by the United States Government under either the Internal Revenue Code or the United States-United Kingdom Income Tax Convention, and where the effect of the State's application of its formula is to apportion some of the income of the nonresident United Kingdom corporation and its non-United States subsidiaries to the American subsidiary for taxation by California where:

(a) The entire income of the United Kingdom corporation and of its non-U.S. subsidiaries, all of which is

included in the combined unit California would apportion, has already been taxed in full by the United Kingdom and the other host countries, and California allows neither a deduction for those taxes nor a credit for them against its own tax, thus producing multiple taxation of income earned in foreign commerce; and

(b) The income of the American subsidiary is swollen by the apportionment to it of some of the income of the United Kingdom parent and its non-U.S. subsidiaries, far beyond any conceivable earning capacity of the American subsidiary from the conduct of its own business; and

(c) The apportionment of the combined net income by the three-factor formula of the ratio of California property, payroll and sales to the combined world-wide property, payroll and sales of the United Kingdom parent and its non-U.S. subsidiaries, is made on the basis of estimates, first because the Official Secrets Act of the United Kingdom prohibits the United Kingdom corporations from revealing some of the information essential to the application of the California formula, and second because the wages paid by the non-U.K. subsidiaries are not reported to the United Kingdom parent and are for years before California made its demand and cannot now be assembled; and

(d) There is no uniformity between the economic environment in which the American subsidiary operates and those in which the non-U.S. corporations operate, most notably because the wage rates in the United States for the years before the Court were

higher than prevailing in any other country in which the corporations which California would consolidate operate, with the result that each factor in the formula is weighted to apportion more net income to California than could be earned in that state by the business conducted in it, such income being therefore derived from that properly taxable by the United Kingdom and the other foreign countries where the businesses are conducted; and

(e) where the businesses of the United Kingdom parent, its non-U.S. subsidiaries, and the American subsidiary which are being combined consist primarily of the recording in each country of music popular in that country, the making of records and tapes in the country in which the recording was made, and the sale of those records and tapes to the residents of that country, but sales of records in foreign commerce are made by both the U.K. parent and the American subsidiary to customers of their choice, and under a reciprocal matrix exchange agreement both the U.K. parent and the American subsidiary make records of music initially recorded by the other; and

(f) where the effect of the California formula is to tax to the American subsidiary income earned and received exclusively abroad by other corporations from business conducted locally in other countries or in foreign commerce which income California would not have jurisdiction over directly because of International Law, of the United States-United Kingdom Income Tax Convention, and of Section 381, Title 15, United States Code.

3. Does the United States-United Kingdom Income Tax Convention in effect in the years 1968-1974 prohibit a state's apportioning by formula to an American subsidiary some of the income of its United Kingdom parent corporation where under the treaty the United States cannot tax any of the income of the United Kingdom parent because it does not have a permanent establishment in the United States?

PARTIES TO THE PROCEEDINGS BELOW

There is no other party to this proceeding. Capitol Industries-EMI, Inc. is a party to a companion but unconsolidated case which was joined in the Court of Appeals for argument. It will be affected by the outcome. A petition will also be filed for it.

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Plaintiff, Appellant and Petitioner,

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Defendants and Appellees.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals for the Ninth Circuit Prior to Entry of Decision in That Court and While Case Is Pending Therein

EMI Limited, a corporation of the United Kingdom, plaintiff in the United States District Court and appellant in the United States Court of Appeals for the Ninth Circuit, petitions for a Writ of Certiorari under Rule 18 of this Court to review the case now pending in and not yet decided by the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

There is no opinion of the Court of Appeals. The opinion of the District Court is not officially reported, but is appended hereto in Appendix A.

JURISDICTION

The jurisdiction of this Court is invoked under Section 2101(e) of Title 28, United States Code. No decision has yet been rendered by the United States Court of Appeals, where the case was argued and submitted for decision on October 15, 1981. The decision of the District Court, Northern District of California, granting summary judgment to defendants was entered on February 12, 1980, and Notice of Appeal was filed by plaintiff-appellant on March 4, 1980. Plaintiff-Appellant's opening brief on appeal was filed July 16, 1980. All briefs were filed before the end of 1980.

The jurisdiction of the federal court was invoked under Sections 1331 and 2201, Title 28, United States Code. Plaintiff has no judicial remedies available to it in the California courts under California statutes and constitution, and for that reason the provisions of Section 1341, Title 28, United States Code, do not remove this case from the jurisdiction of the federal courts.

STATUTES, CONSTITUTIONAL PROVISIONS AND TREATIES INVOLVED

1. The sections of the Judicial Code involved are Sections 1331, 1341 and 2201, Title 28, United States Code. They are set forth verbatim in Appendix B.

2. The sections of the United States Constitution involved are the Commerce Clause (Art. I, Sec. 8, cl. 3), the Import-Export Clause (Art. I, Sec. 10, cl. 2), and Art. I, Sec. 8, cl. 1 and 10, and Art. I, Sec. 10, cl. 1 and 3; and Art. II, Sec. 2, cl. 1 and 2, Art. III, Sec. 2, cl. 1 and 2, and Art. VI, cl. 2 and 17. All are set forth in Appendix C.

3. The United States-United Kingdom Income Tax Convention in effect in the years involved in this case. The text of the relevant provisions is set forth in full in Appendix D.

4. Section 381 of Title 15, United States Code, is also involved. Its text is set forth in Appendix E.

STATEMENT OF THE CASE

This case is one to restrain defendant California State tax officials from assessing a tax against plaintiff's subsidiary, Capitol Industries-EMI, Inc., on a portion of plaintiff's income from its business done exclusively in foreign and local commerce from and in the United Kingdom, in violation of a federal treaty statute and constitutional law.

Plaintiff, EMI Limited, is a corporation formed in the United Kingdom, which owns all or substantially all of the stock of approximately 100 subsidiary corporations, some of which are formed under the laws of the United Kingdom, and others of which are formed under the laws of the various countries in which they operate. They operate in and are formed under the laws of more than 30 countries in Western Europe, North America, the Near East and the Far East of Asia, South America, South Africa, and Australasia. Capitol Industries-EMI, Inc. is one such sub-

sidiary, and has been since plaintiff acquired a majority of its stock in 1956. Capitol Industries-EMI, Inc. (hereinafter "Capitol") is formed under the laws of the United States, has its principal office and plant in Hollywood, California, and has other plants in Illinois, Virginia and Connecticut.

EMI Limited does not do business in the United States and does not have a permanent establishment in this country. It is therefore not subject to United States tax by treaty. In its corporate self it does no business outside of the United Kingdom. EMI's worldwide subsidiaries make approximately 20% of all of the phonograph records made in the Western world, and own pressing plants located in 13 countries. Three of these plants are in the United States, owned by Capitol. In addition to that type of music business, through subsidiaries operating in several countries, but not in the United States, the EMI group is in the business of retailing phonograph records and prerecorded tapes, and sheet music.

Subsidiaries of EMI also operate a variety of other businesses: the manufacture of television cameras, antennae and transmission equipment, and of security devices; the operation of a movie studio at which both television films and films for the theater are made; the operation of movie theaters, bingo parlors, hotels, restaurants, and places of amusement; the manufacture for the government of the United Kingdom and certain governments of NATO of military equipment, much of which employs radar principles pioneered and in some instances invented by EMI; and the development and production of equipment

in the field of medical electronics, the most notable of which is the invention and patenting of the brain scanner and body scanner. Capitol conducts no business other than the making of phonograph records and pre-recorded tapes, and at times the manufacture and sale of raw tapes for use by other recording companies.

Initially, defendants demanded information of EMI Limited, threatening it with monetary penalties if it did not reply. EMI informed them that it was not within the jurisdiction of California, could not supply some of the information sought because of restrictions of the Official Secrets Act of the United Kingdom, and did not possess other of the information sought because it was not supplied to EMI by EMI's non-U.K. subsidiaries. Defendants then made the same request for information of Capitol, with the same threat of a penalty, and Capitol informed defendants that it could not supply information about EMI which it could not get from EMI. Defendant's staff then compiled figures about EMI available from public sources in the United States, and assessed a proposed additional tax against Capitol based upon what they believed to be the total net income of EMI and all of its worldwide subsidiaries, and an apportionment of it to California based upon the ratio which the California property, payroll and sales of Capitol bore to what defendants estimated was the total worldwide property, payroll and sales of EMI and its subsidiaries. The non-U.K., non-U.S. property and payroll figures were unknown and defendants substituted their estimates. Capitol protested this action, conferences were held by Capitol representatives with defendants and their representatives, and those representatives informed Capitol that defendants

would adhere to their position, until such time as Capitol provided the information defendants had sought from EMI. Plaintiff EMI Limited and Capitol Industries-EMI, Inc. both then filed cases in the United States District Court for the Northern District of California against the defendants, to restrain such an assessment against Capitol, and in EMI's case to restrain defendants from lessening the value of EMI's investment in the United States, through the assertion of unconstitutional taxes from Capitol, from burdening EMI's foreign commerce with the United States, and for other relief.

Cross-motions for summary judgment were filed, in plaintiff's motion supported by extensive affidavits of officers of EMI and Capitol, and documentary exhibits. While these cases were pending in the United States District Court, defendants' representatives proposed to Capitol's representatives that defendants would change the basis of assessment, to combine Capitol only with EMI's music business. Capitol's representatives informed defendants' representatives that the information they needed for such a modified combination and apportionment was not available, so the representatives of defendants devised figures based upon assumptions and estimates and employed those in the apportionment formula in substitution for the figures that they had previously used which had represented the entire worldwide business of plaintiff. The effect was to reduce the deficiency, but a substantial deficiency in excess of $800,000 still remains in issue for the years determined by defendants, and an unknown but certain amount for later years.

The District Court rendered summary judgment for defendants, holding that for purpose of Section 1341, plaintiff

EMI Limited, although not having any judicial remedy in the California courts, must be deemed to have the remedy California law afforded to Capitol. Neither EMI nor Capitol admits that Capitol has a "plain, speedy and efficient" remedy in the California courts, but it is not disputed by defendants that EMI has none at all. Appeal was taken, and the issues were briefed both on the jurisdictional point and on the merits, oral argument was had in both cases and on both aspects, and the cases are awaiting decision.

This petition before judgment below is filed to enable this Court, if it so desires, to add a case involving a foreign parent in a multi-national group of corporations with American subsidiaries to those cases which it will consider, involving the Constitutional validity of combination of domestic parents with their foreign subsidiaries and the apportionment of the combined income, or in two cases, the application of apportionment formulae to the dividend income of American parent corporations, paid to them by foreign affiliates from their business conducted either in foreign countries or in foreign commerce between the United States and foreign countries.

EMI does operate in foreign commerce between the United Kingdom and the United States. Its subsidiaries sell completed phonograph records to a United States outlet, but not to Capitol. It and its subsidiaries have a matrix exchange agreement with Capitol, modeled closely after the one which EMI Limited had with RCA before EMI acquired controlling interest in Capitol, under which each party has an option to license a duplicate matrix of recordings made by the other, to make recordings of the music embedded on that matrix and to sell them in their market

ing areas. This agreement is entirely reciprocal, giving EMI precisely the same rights in respect of matrices of music recorded by Capitol as it gives Capitol for matrices made by EMI. The agreement confers an option right on each party, and does not bind either party to take any of the matrix offerings of the other. The license fees and other amounts paid for the privilege are entirely reciprocal, so that the amounts paid by Capitol to EMI are the same as the amounts paid by EMI to Capitol, per unit manufactured.

Both EMI and Capitol contend that they are not engaged together in a single unitary business, and that the income of each can be readily ascertained by the arm's length method used by the United States Government under Section 482 of the Internal Revenue Code, and by all foreign governments. They also contend that taxing Capitol on an apportioned amount of EMI's income represents a forbidden burden of foreign commerce, contrary to the Constitution of the United States, and contrary to international law, to the United States-United Kingdom Income Tax Convention, and to Section 381, Title 15, United States Code.

REASONS FOR GRANTING THE WRIT

1. This Court has accepted jurisdiction of three cases[1] presenting various aspects of the constitutional issues

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[1] *Asarco Inc. v. Idaho State Tax Commission*, No. 80-2015, Oct. Term 1981; *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., Illinois Department of Revenue*, No. 81-349 Oct. Term 1981; *F.W. Woolworth Co. v. Taxation and Revenue Department*, No. 80-1745 Oct. Term 1981.

raised by the application of their combined apportionment formulae by states to foreign source income of foreign subsidiaries of domestic parent corporations. The court has scheduled them for argument at this Term. The urgency of this case is that it presents another, and vitally important aspect of the same problem: viz, the application of such combined apportionment formulae to the foreign source income of foreign parent corporations with an American subsidiary. This aspect of the problem should be considered while the Court is considering the other cases. Considerations unique to the foreign parent, such as treaties, double taxation of the before-tax income, and the fact the foreign source income of foreign parents will never be paid into the United States, and will never be within the reach of the United States, are considerations the Court should have presented to it on plenary argument, and will not have before it in cases involving American parent corporations.

2. There is no more serious international controversy involving the United States in the area of taxation than that which has been engendered by the insistence of certain states on applying their combined unitary apportionment formulae to foreign-based multinational corporations and their foreign subsidiaries, and then combining them with their American subsidiaries. The President of the European Economic Community filed a protest with the Department of State against this practice, in 1980. A copy of that letter is included herewith as Appendix F. The Government of the United Kingdom also filed a letter of protest with the Department of State in 1980. A copy of that letter is included as Appendix G. Members of Parliament of the United Kingdom have gone so far as to testify before a

Congressional Committee in Washington in support of bills which would prohibit states' including foreign source income of multinational corporate groups owned by foreign corporations within their combined unitary apportionment formulae. Both of the letters referred to above were written to the Department of State after the United States Senate refused, by two votes less than the two-thirds required for approval, to approve the explicit prohibition of such practice in the new United States-United Kingdom Income Tax Convention.

3. The International community has shown much more concern with the avoidance of duplication of income taxes than it has with the duplication of property taxes. There are presently 40 such treaties, either in effect between the United States and foreign countries or signed and in the process of ratification. The concern this Court expressed in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), about duplication of taxation in foreign commerce and the retaliatory effect that could be expected from permitting a state to impose taxes on foreign commerce which duplicate the tax burden imposed by the home nation, should be even greater here. The duplication of income taxation in the international sphere is an issue of much bigger international importance than was the duplication of property taxes this Court disapproved in *Japan Line.* As we will show hereafter, the retaliation which this Court foresaw would follow from the duplication of tax involved in *Japan Line,* if this Court had permitted it to occur, has already occurred in the international income tax sphere. The EMI Limited case and its companion case, Capitol Industries-EMI, Inc., are excellent vehicles for the

consideration of the impact of this type of combined formula because the feared duplication of tax exists in fact, and the ultimate equity owner of the income which has been taxed twice is a foreign corporation, formed under the laws and operating in a treaty nation, and having no permanent establishment in the United States. The impact of any decision in this area involving domestically-owned multinational corporate groups cannot be fully assessed by this Court without consideration of the possible impact of such a decision on foreign parents of multinational groups which have one or more subsidiaries operating in the United States.

4. The action defendants would take is in violation of the treaty then in effect. While it seems not to be a model of clarity to eyes accustomed to distinguishing between state and federal governments, the treaty does contain clear indications that the treaty binding "the United States" was intended to bind all 50 of them. The treaty language was intended to be understood on both sides of the Atlantic, and in diplomatic usage "State" means "nation". The treaty refers repeatedly to corporations "created or organized in or under the laws of the United States". All American private business corporations are organized under the laws of some State, so the term United States is clearly used to mean the states, and if that meaning is applied throughout defendants are in violation of the treaty. Plaintiff EMI Limited does not have a permanent establishment in the United States and is exempted from United States taxes by the treaty.

5. International law prohibits what defendants seek to do, this Court should so declare, and in this case can do so.

Unlike the situation in the *Japan Line* case, here there is an entire absence of nexus. EMI Limited has no property of its own or office in California. Under International law ownership of the stock of Capitol does not establish the presence of EMI in every State in which Capitol operates. International law is based on custom and settled practice as much as on treaties and agreements. *The Paquette Habana*, 175 U.S. 677, 686, 708 (1900). Every state is subordinate to International law. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 425 (1964). The international custom to respect the distinction between foreign parent and domestically formed subsidiary is so thoroughly accepted that it is in each of the forty income tax treaties the United States has signed and in addition is universally respected between nations where there is no treaty. Thus, for example, Mexico and the United States, and Colombia, Venezuela, Peru, Chile and Spain, and the United States, all recognize the custom in the absence of treaty.

The official position of the Executive about what is prevailing international custom binds the American courts (Draft Restatement of Foreign Relations Law (Revised) American Law Institute, Sec. 132 (3)). In 1977 both Secretary of the Treasury Blumenthal and Assistant Secretary Woodworth testified before the Senate Foreign Relations Committee that the California combined unitary apportionment method was contrary to "the internationally accepted approach" and "is inconsistent with accepted tax treaty policy." (Hearings Before the Senate Foreign Relations Committee, July 19, and 20, 1977, 95th Cong. 1st. Sess. pp. 20-21, 412, 489-490.)

Notes from the Government of the United Kingdom and the President of the European Economic Community to the United States Department of State have spoken of the competing allocation method required by all treaties in force, known as the "arms-length basis", as the "internationally accepted" one, and have protested California's departure from it. (Appendix F, Appendix G.)

The importance of this Court's early review of California's departure from International law, in conjunction with the three cases it is reviewing, justifies the Court's review of this case at this time.

6. In *Japan Line, Ltd. v. County of Los Angeles, supra,* this Court predicted that foreign governments would be driven to retaliate against the United States if American states were permitted to impose a duplicating tax on property already, and properly, taxed in the home country. California's tax practices typified by what defendants are seeking to do here have already produced retaliation by the United Kingdom. The new U.S.-U.K. Income Tax Convention as signed, and approved by the British Parliament, contained an express prohibition of California's combined formula as applied to United Kingdom parents and their American subsidiaries. The United States Senate approved the treaty except for that provision, which narrowly failed to obtain two-thirds approval. This required that the British Parliament ratify the treaty without that provision, which for two years it refused to do. It insisted on another revision, the Third Protocol (Appendix H), which had the effect of permitting increases in the taxation of American

corporations operating in the British North Sea. The retaliatory effect is not confined to California's corporations.

There is no assurance other countries will not also retaliate against the California combined formula. There are nine members of the EEC who joined in the denunciation of the California practice. Since one has already retaliated, it is reasonable to expect others to do so. Certainly the danger this Court foresaw if the States are free to impose multiple tax burdens on foreign commerce is present here, and this Court should review the permissibility of the California method as soon as possible.

This case provides a suitable vehicle.

7. Defendants are seeking to do by indirection what Section 381, Title 15, United States Code, says they cannot do directly. That code section prescribes the nexus necessary for tax on income derived from interstate commerce. This Court should decide that it applies also to foreign commerce, and that it cannot be avoided by the subterfuge of assigning income of the nontaxable foreign corporation to a domestic subsidiary which is within reach.

8. a. Section 1341, Title 28, United States Code, is not a bar to jurisdiction. The California courts are completely closed to EMI and can afford it no remedy at all. California prohibits injunctions and other prepayment remedies to restrain tax assessments. Cal. Const. Art. XIII, Sec. 32; Rev. & Tax Code Section 26101 (Appendix I). It permits only suits for refund, but limits them to those brought by a tax payer for refund of taxes he has paid. Rev. & Tax Code Sec. 26102. EMI will not be the one defendants' will

assess so EMI will not be able to sue for a refund. It is without remedy in the California courts.

The availability of a remedy to another party, even a related one, does not bring the exclusion of Sec. 1341 into operation. *D.C. Transit System Inc. v. Pearson,* 149 F. Supp. 18 (D.C. 1957); *Builders & Developers Corp. v. Manassas I. & S. Co.,* 208 F. Supp. 485 (D.C. Md., 1962); and under 26 U.S. Code Section 7421(a), to the same effect are *Adler et al. v. Nicholas,* 166 F.2d 674 (10th Cir. 1948), *Shelton v. Gill,* 202 F.2d 503 (4th Cir., 1953), and *Glenn v. American Surety Co.,* 160 F.2d 977 (6th Cir., 1947).

Furthermore, the related party, Capitol, does not have a "plain, speedy and efficient remedy" in the state courts either, as we show in our petition in the related case of that corporation.

Moreover, only EMI, as a corporation protected by one contracting party to the U.S.-U.K. Tax Convention, the United Kingdom, is entitled to raise the issue of treaty protection, and the federal court is the only forum available to it. To deny it access to federal court is to deny it treaty protection and the United Kingdom treaty rights it bargained for.

b. The issues presented are peculiarly federal issues. With several other states following California's lead in applying combined formulae to the foreign source income of foreign parent corporations no state supreme court can render a decision conclusive on all. Considerations of comity are absent here, as they are in the three cases this Court will review. This case should be given plenary consideration along with them.

CONCLUSION

The petition for the writ of certiorari prior to decision in the Court of Appeals should be granted.

December 9, 1981.

Respectfully submitted,

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Appendix

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APPENDICES TO

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

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APPENDICES

APPENDICES

A. Opinion Below

B. Judicial Code Sections

C. United States Constitutional Provisions

D. United States - United Kingdom Income Tax Convention

E. 18 US Code 381

F. Letter from President, European Economic Commission

G. Letter from Government of United Kingdom

H. Third Protocol

I. California Constitution & Statutes

Appendix A

Opinion Below

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

CAPITOL INDUSTRIES-EMI, LIMITED Plaintiff, vs. WILLIAM M. BENNETT, et al., Defendants.	No. C-79-2145-CBR
EMI LIMITED, Plaintiff, vs. WILLIAM BENNETT, et al., Defendants.	No. C-79-2146-CBR ORDER GRANTING SUMMARY JUDGMENT

These two related cases were consolidated for the purpose of hearing cross motions for summary judgment. Plaintiff in Case No. C-79-2145-CBR, Capitol Industries-EMI, Limited

("Capitol Industries"), is a Delaware corporation with its principal place of business in California. It is the sole stockholder of Capitol Records, Inc. In the second case, No. C-79-2146-CBR, plaintiff is EMI Limited, the parent of Capitol Industries and a United Kingdom corporation which has many foreign subsidiaries and no permanent establishment in the United States. Defendants in each case are members of and the chief executive officer of the California Franchise Tax Board. At issue are the efforts of the California Franchise Tax Board to assess additional taxes on Capitol Industries based upon application of California's unitary tax, Cal.Rev.&Tax.Code §§25101 et seq., to the operations of Capitol Industries parent, EMI Limited, and its other foreign subsidiaries.

The motions for summary judgment were extensively briefed and very well argued by counsel for both parties. Indeed, the Court is most appreciative of the time and effort given by counsel to this complex matter and

the gracious attempts they made to educate the Court in the complexity of the unitary tax.

While the Court has substantial question as to the ultimate constitutionality of the California unitary tax being applied to foreign corporations with foreign subsidiaries, particularly in light of Japan Lines, Ltd. v. County of Los Angeles, ____ U.S. _____, 60 L.Ed.2d 336 (April 30, 1979), this does not entitle plaintiffs to the injunctive relief they seek. Even assuming the unconstitutionality of such a tax, the California statutes afford the taxpayer in this case, Capitol Industries, an opportunity to have any mistake rectified. A taxpayer which believes that it has been illegally overassessed may protest the additional assessment, Cal.Rev.&Tax.Code §25664. If the protest is denied, the taxpayer may file an appeal with the State Board of Equalization, Cal.Rev.&Tax.Code §25667. Finally, the taxpayer may bring an action against the Franchise Tax Board for a refund, Cal.Rev.&

Tax Code §26102. Under these circumstances, there exists a plain, speedy, efficient state remedy which precludes intervention by the federal court. Aronoff v. Franchise Tax Board, 348 F.2d 9, 11 (9 Cir. 1965). The parent, EMI Limited, argued that it had no such remedy, since it had no standing before the state administrative agencies or in the state courts. However, its interest in opposing the assessment based upon the unitary tax is identical or substantially identical to that of Capitol Industries, which does have access to state administrative agencies and state courts. Under these circumstances, the Court finds that their interests being identical, EMI Limited has in effect a plain, speedy, and efficient state remedy as to the matters of which it complains. Accordingly, the Court finds that plaintiffs have failed to exhaust their state remedies and on that ground will grant defendants' motion for summary judgment.

IT IS HEREBY ORDERED that plaintiff's motions for summary judgment are denied and defendants' motions for summary judgment are granted.

IT IS HEREBY FURTHER ORDERED that counsel for defendants shall prepare an appropriate form of judgment in accordance with this order and submit it to the Court for execution within ten (10) days.

Dated: February 4, 1980.

Charles B. Renfrew

Charles B. Renfrew
United States District Judge

APPENDIX B:

Judicial Code Sections.

Section 1331.

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States, except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee thereof in his official capacity.

Section 1341.

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such State.

Section 2101.

(e) An application to the Supreme Court for a writ of certiorari to review a case before judgment has been rendered in the court of appeals may be made at any time before judgment.

Section 2202.

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 [26 USC § 7428], any

court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

APPENDIX C:

United States Constitution:

Article I, § 8, Cl. 3. Power of Congress to regulate Commerce.

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Art 1, Section 10, Cl 1

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Art 1, Sec. 10, Cl 2

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Art I, Sec. 10, Cl 3

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or

engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Sec. 2, Cl. 2. Treaties

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consult, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

Art I, Sec. 8, Cl. 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art I, Sec. 8, Cl 10

To define and punish Piracies and Felonies committed on the High Seas, and Offenses against the Law of Nations.

Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, -to all Cases affecting Ambassadors, other public Ministers and

Consuls; -to all Cases of admiralty and maritime Jurisdiction' -to Controversies to which the United States shall be a Party; -to Controversies between two or more States; - between a State and Citizens of another State; -between citizens of different States, - between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Art III, Sec. 2, Cl 2

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the Supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the Supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

APPENDIX C:

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He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

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Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, -to all Cases affecting Ambassadors, other public Ministers and Consuls; -to all Cases of admiralty and maritime Jurisdiction' -to Controversies to which the United States shall be a Party; -to Controversies between two or more States; - between a State and Citizens of another State; -between citizens of different States, - between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Art III, Sec. 2, Cl 2

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the Supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the Supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

APPENDIX D:

Relevant Sections, United States-United Kingdom Income Tax Convention of 1946.

Article I.

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States of America: the Federal income taxes, including surtaxes (hereinafter referred to as 'United States tax');

(b) In the case of the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the corporation tax, and the capital gains tax (hereinafter referred to as 'United Kingdom tax').

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequent to the date of signature of the present Convention by the government of any territory to which the present Convention is extended under Article XXII."

Article II.

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States means the United States of America, and when used in a geographical sense means the States,

the Territories of Alaska and of Hawaii and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridicial person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be

regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purpose of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not

include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a bona fide commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

* * *

Article III.

(1) Industrial or commercial profits of an enterprise of one of the Contracting Parties shall be exempt from tax by the other Party unless the enterprise is

engaged in trade or business in the territory of such other Party through a permenent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such Party on the industrial or commercial profits of the enterprise but only on so much of them as are directly or indirectly attributable to the permanent establishment.

(2) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

* * *

APPENDIX E:

Title 15;

§381.

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act [Sept. 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to:

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in any business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, or tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office of such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, or tangible personal property.

(d) For purposes of this section:

(1) The term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

APPENDIX F

(Letter from Ambasciata D'Italia,
Washington, D.C.)

The Italian Embassy presents its compliments to the Department of State and, on behalf of the Nine EEC Governments, of which the Italian Government has now the presidency, it has the honor to forward the attached Note on the problems of the unitary method of taxation.

The Italian Embassy welcomes the opportunity to renew to the Department of State the assurances of its highest consideration.

(Signature)

Washington, D.C.
March 19, 1980

To the
Department of State
Washington, D.C.

UNITARY TAXATION

1. Our Governments are concerned about the application to US subsidiaries of foreign companies of the unitary basis of taxation as applied in California and in varying degrees by certain other States.

2. The unitary basis makes no attempt to examine the profits generated by the subsidiary. It looks to the total profits of the worldwide operations of the group of which the subsidiary is a part, and claims a portion of those profits on the basis of the assumption that certain specified factors, such as the fixed asset values, turn-over and payroll, affect the profits of the subsidiary in the same way and to the same extent as the profits of the group as a whole, irrespective of where the corporations of the group operate. This means that, whenever the group as a whole makes a profit the subsidiary will be taxed on a portion of this profit, even if the subsidiary is actually making a loss, or in the reverse situation, that the subsidiary may not be taxed if the group as a whole has made a loss, although the subsidiary is actually in a profit making position.

3. This method is incompatible with the principles accepted by all OECD member states and recommended to all states as a basis for the taxation

of subsidiaries or permanent establishments of foreign enterprises. These principles require that a subsidiary should be taxed only on the profits it actually has made, provided that these are based on dealing at "arm's length" between the subsidiary and related enterprises, i.e. that the transactions between the subsidiary and related corporations are on the same or on a comparable basis as transactions between wholly independent parties. This is intended to arrive at a fair measure of profit and rule out artificial pricing between members of the group for the sole purpose of minimizing tax liability.

4. Unless the same basic rules for calculating taxable profits are followed generally by the main trading nations it will be impossible to achieve the essential objective of providing a consistent and coherent international tax framework for trade and investment.

5. The unitary tax basis can give rise to obviously inequable tax liabilities, and to a form of double taxation which often cannot be relieved, or can be relieved only if countries, which follow generally accepted practices, bear an unfair burden of relief.

6. Unitary taxation, because it requires worldwide reporting of the group's activities in the state where the subsidiary operates imposes very heavy compliance costs, in addition to the costs of compliance and reporting for non-US corporations in their "home countries".

7. The Federal Government uses the arms-length basis for its taxation of subsidiaries of foreign corporations.

8. The problem was addressed in the US/UK Double Taxation Treaty. Article 9(4) of the Treaty, which was supported by the Administration, would have disallowed the imposition of unitary taxes on subsidiaries of UK companies. When the Senate voted on the Treaty in 1978 the majority approved the Treaty with Article 9(4) in its original form, although the necessary two-thirds majority was not achieved. Subsequently, the Senate approved the Treaty with the necessary two-thirds majority, but subject to the reservation that Article 9(4) was not to apply for the purpose of state taxation. Article 9(4) remained in the Treaty, but only for the purpose of national taxation.

9. There are currently four relevant bills in Congress. S983, S1688, HR 5093, HR 5076, the last of which is scheduled for hearings on the 31st of March.

In the view of the strong arguments against unitary taxation, our Governments urge you to support this legislation in so far as it relates to the unitary tax issues raised above, with a view to early enactment.

Washington, D.C.
March 19, 1980

APPENDIX G

(Press Release, issued by British Embassy Information Department, 3100 Massachusetts Avenue, N.W., Washington, D.C. 20008)

UK/US DOUBLE TAXATION CONVENTION

The ratification by the Exchange of Instruments of the US/UK Double Taxation Convention took place in Washington on 25 March 1980.

The Convention enters into force on 25 April 1980.

Attached is an outline of the views which have been communicated by Her Majesty's Government to the US Administration at the time of ratification.

Contact: Mr. A S Winckler or Mr. A J Perry,
British Embassy,
Tel: 462 1340

EXHIBIT G, Continued

UK/US DOUBLE TAXATION CONVENTION

The Double Taxation Convention between the UK and the US, which was signed in London on 31 December 1975, and the three supplementary Protocols which were signed in London on 26 August, 1976, 31 March 1977 and 15 March 1979 respectively were ratified by the Exchange of Instruments in Washington on 25 March 1980.

The Convention, as amended by the Protocols, will enter into force on 25 April 1980.

The following views have been conveyed by Her Majesty's Government to the US Administration.

It is a matter of regret to Her Majesty's Government that difficulties over one aspect of the Convention, although it is an important one, should have tended to obscure the achievement of the two Governments in reaching a fair and balanced agreement.

Among double taxation treaties, that between the British and United States Governments has a pre-eminent position. The economic and financial links between the two nations are so strong and the areas covered so diverse that, apart from its intrinsic importance to the United Kingdom and the United States of America, the Convention attracts wide interest internationally and is a source of authority in its field.

Her Majesty's Government is therefore gravely concerned that as a result of the amendment resulting from the United States Senate reservation on Article 9(4) the Convention does not comprehensively restrict the application of the unitary basis of taxation. That Article in its original form would have prevented the United States Government and the individual States of the United States of America from applying this basis to United Kingdom corporate

groups which have subsidiary companies in the United States. In its final form the Article applies only for the purposes of United States federal tax, where the unitary basis is not employed, and does not cover individual States of the Union. This is not only a set-back for British corporate investment in the United States. It may also be interpreted as awarding some approval for the unitary basis of taxation and could have wider repercussions.

Her Majesty's Government is convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is entirely unsatisfactory. The Organisation for Economic Co-operation and Development has explored, encouraged and developed the "arm's-length" principle for regulating the taxation of multinational enterprises operating through subsidiary companies or branches. This principle requires that the subsidiary or branch should be taxed only by reference to the profits which its own activities generate. Where these activities involve transactions with related enterprises and these transactions are not on the basis which would be made between wholly independent enterprises, the profits are to be adjusted for tax purposes by reference to the independent enterprise test i.e., the "arm's-length" basis. This is intended to achieve a fair measure of the profit by cancelling the effect of any artificial pricing between related enterprises. The "arm's-length" approach has been internationally accepted and is a vital feature of double taxation conventions throughout the world.

In other parts of the world where they are already taxed, even though the local subsidiary is incurring substantial losses. On the unitary basis there is likely to be unrelieved and unrelievable double taxation. In addition the compliance costs are unacceptably high.

Apart from these inherent problems associated with the unitary tax basis, its incompatibility with the internationally accepted "arm's-length" basis would generate conflicts between the international investing and trading nations and disruption of international business if the precedent implicit in the Convention were to be followed by other countries. Unless common rules for determining the allocation of profits between different taxing jurisdictions are followed internationally it will be impossible to preserve the essential objective of providing a consistent and coherent international tax framework for business and investment, for which the United States and the United Kingdom have striven together with their fellow members of the Organisation for Economic Co-operation and Development. It is the view of Her Majesty's Government that the unitary basis, which is not a practical international alternative to the "arm's-length" basis, could undo the important and patient international work that has been achieved in regulating international tax practices, and that every effort is required to discourage the use of the extension of that basis. It is to this end that the British and United States Governments have expressly prohibited its use for the purpose of the respective national tax systems under Article 9(4); and the issue will be an important aspect of the proposed annual review of the Convention.

Her Majesty's Government has recognised, in ratifying this Convention with the approval of the United Kingdom Parliament, and in its acceptance of the United States Senate reservation against Article 9(4) of the Convention, the difficult issues raised within the United States in seeking to limit State taxing powers through the double taxation conventions of the United States. It has also recognised the importance of the Convention in its many other aspects for the two Governments and for the business and investment communities on each side. It must be emphasised however that the acceptance of the Senate reservation in no way implies approval of the unitary basis and it is the urgent request of Her Majesty's Government for the reasons given above that the Government of the United States should use its best endeavours to eliminate the international application of the unitary basis of taxation.

APPENDIX H:

(Appendix C to Letter of Transmittal of the Third Protocol to the Senate on April 12, 1979)

[43] APPENDIX C

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of
The Treasury
Washington, D.C.
June 8, 1979.

HON. FRANK CHURCH
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again, let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

* * * * *

[45] Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the propsed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration

and exploitation connection activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any reference to "an installation of drilling rig or ship used or the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists, that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the

Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY:

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by

the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the

actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to the U.S. investors of the British Advance Corporation tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

* * * *

THIRD PROTOCOL FURTHER AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS, SIGNED AT LONDON ON 31 DECEMBER 1975.

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a third Protocol to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 and by Protocols signed at London on 26 August 1976 and 31 March 1977 (hereinafter referred to as "the Convention"):

Have agreed as follows:

ARTICLE I

(1) Paragraph (2) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(2) The existing taxes to which this Convention shall apply are:

(a) in the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the tax on insurance premiums and the tax on insurance premiums paid to foreign insurers; but (except as provided in paragraph (6) of Article 10 (Dividends) excluding the accumulated earnings tax and the personal holding tax. The foregoing taxes covered are hereinafter referred to as "United States tax";

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax, and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax".

(2) Paragraph (3) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws."

(3) Paragraph (4) of Article 9 (Associated enterprises) shall be delated and replaced by the following:

"(4) Except as specifically provided in this Article:

(a) Where an enterprise doing business in Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(b) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) A controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the principle thereof); nor

(ii) created or organised under the laws of the first-mentioned State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State; then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, such State shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise."

ARTICLE II

The following new paragraph 6(A) shall be added to Article 7 (Business profits) after paragraph (6):

"(6A) The United States tax on insurance premiums paid to foreign insurers shall not be imposed on insurance on reinsurance premiums which are the receipts of a business of insurance carried on by an enterprise of the United Kingdom whether or not that business is carried on through a permanent establishment in the United States."

ARTICLE III

Paragraph (5) of Article 10 (Dividends) shall be deleted and replaced by the following:

"(5) Where a corporation which is a resident of a Contracting State (and not a resident of the other Contracting State, that other State) derives profits or income from State may not impose any tax on the dividends paid by the corporation, except insofar as such dividends are paid to a resident of that other State(and where that other State is the United States, to a national of the United States) or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in that other State."

ARTICLE IV

Sub-paragraph (b) of paragraph (1) of Article 19 (Government service) shall be deleted and replaced by the following:

"(b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident and a national of that State."

ARTICLE V

Paragraph (4) of Article 23 (Elimination of double taxation) shall be deleted and replaced by the following:

"(4) Notwithstanding sub-paragraph (a) of paragraph (1) of this Article, the amount of United Kingdom petroleum revenue tax allowable as a credit against United States tax shall be limited to the amount attributable to United Kingdom source taxable income in the following way, namely:

(a) The amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom to be allowed as a credit for a taxable year shall not exceed the amount, if any, by which the product of the maximum statutory United States tax rate applicable to a corporation for such taxable year and the amount of such income exceeds the amount of other United Kingdom tax on such income.

(b) The lesser of (i) the amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom that is not allowable as a credit under the preceding sub-paragraph, or (ii) 2 per cent of such income for the taxable year shall be deemed to be income taxes paid or accrued in the two preceding or five succeeding taxable years, to the extent not deemed paid or accrued in a prior taxable year, and shall be allowable as a credit in the year in which it is deemed paid or accrued subject to the limitation in sub-paragraph (a) above.

(c) The provisions of sub-paragraphs (a) and (b) shall apply, separately, mutatis mutandis (but with the deletion, in the case of (b), of the words "the lesser of (i)" and "or (ii) 2 per cent of such income for the taxable year"), to the amount of United Kingdom petroleum revenue tax on income from initial transportation, initial treatment and initial storage of minerals from oil or gas wells in the United Kingdom".

ARTICLE VI

The following new Article 27A (Offshore activities) shall be inserted after Article 27 (effect on diplomatic and consular officials and domestic laws):

"ARTICLE 27A
Offshore Activities

(1) Notwithstanding the provisions of Article 5 (Permanent establishment) and Article 14 (Independent personal services), a person who is a resident of a Contracting State and carries on activities in the other Contracting State in connection with the exploration or exploitation of the seabed and sub-soil and their natural sources situated in that other Contracting State shall be deemed to be carrying on in respect of those activities a business in that other Contracting State through a permanent establishment or fixed base situated therein.

(2) The provisions of paragraph (1) shall not apply where the activities are carried on for a period not exceeding 30 days in aggregate in any 12 month period. However, for

the purposes of this paragraph, activities carried on by any enterprise related to another enterprise shall be regarded as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the last-mentioned enterprise.

(3) The provisions of Article 8 (Shipping and air transport) shall not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers."

ARTICLE VII

The following new paragraph (7) shall be added at the end of Article 28 (Entry into force):

"(7) Notwithstanding any provisions of the respective domestic laws of the Contracting States imposing time limits for applications for relief from tax, an application for relief under the provisions of this Convention shall have effect, and any consequential refunds of tax made, if the application is made to the competent authority concerned within three years of the end of the calendar year in which this Convention enters into force."

ARTICLE VIII

(1) This Protocol shall be ratified and the Instruments of Ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of 30 days following the date on which the Instruments of Ratification are exchanged and shall thereupon have effect, subject to the provisions of paragraph (3) of this Article, in accordance with Article 28 of the Convention.

(3) Notwithstanding the provisions of Article 28 (Entry into force) of the Convention, the provisions of Article 27A (Offshore activities) of the Convension (as added by Article VI of this Protocol) shall not have effect until the entry into force of this Protocol.

In witness whereof the undersigned, duly authorized thereto by their respective Governments, have signed this third Protocol.

Done in duplicate at London this 15th day of March 1979.

For the Government of the
United States of America:
ROBERT J. MORRIS

For the Government
of the United
Kingdom of Great Britain
and Northern Ireland:
EVAN LUARD

APPENDIX I

CALIFORNIA

CONSTITUTION AND STATUTES INVOLVED

CALIFORNIA REVENUE AND TAXATION CODE:

§25101.

When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); provided, however, that any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not such transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose it to the basis upon which its reapportionment has been made.

§25102.

In the case of two or more persons, as defined in Section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net income was that of one person, or to distribute, apportion, or allocate the gross income or deductions between or among such persons, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper income of any such persons.

§26101.

No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer of this State to prevent or enjoin the assessment or collection of any tax under this part.

§26102.

Except as provided in Section 26103a, after payment of the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed against it under this part is void in whole or in part may bring an action, upon the grounds set forth in its claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid.

CALIFORNIA CONSTITUTION:

Article XIII, § 32. Process to prevent or enjoin collection of tax; action to recover tax paid.

Sec. 32. No legal or equitable proces shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

Opposition

Office - Supreme Court, U.S.
FILED
JAN 7 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1088

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

EMI LIMITED,
Plaintiff, Appellant and Petitioner,

VS.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Defendants and Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Ninth Circuit
Prior to Entry of Decision in That Court and
While Case Is Pending Therein

Brief for Respondents in Opposition

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QUESTION PRESENTED

1. Whether petitioner has standing under article III of the Constitution to bring this action.

2. Whether 28 United States Code section 1341, in any event, bars this action.

3. Whether any treaty prohibits California from applying the unitary method of taxation, not against petitioner, but against a California corporation whose shares of stock petitioner owns.

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No. 81-1088

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

EMI LIMITED,
Plaintiff, Appellant and Petitioner,

VS.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Defendants and Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals for the Ninth Circuit
Prior to Entry of Decision in That Court and
While Case Is Pending Therein

Brief for Respondents in Opposition

I

JURISDICTION

The technical jurisdictional requirements appear to be set forth adequately in the petition except that petitioner has failed to establish its standing to sue. It also should be observed that petitioner's contentions were rejected by the United States District Court for the Northern District

of California based upon and in conformity with the pertinent decisions of this Court and the California courts. Moreover, petitioner's petition to this Court after oral argument but prior to decision by the Ninth Circuit Court of Appeals represents nothing more than a blatant attempt by a non-United States corporation, not subject to United States jurisdiction, to have this Court legislate out of existence California's unitary method of taxation.

II

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. United States Constitution, article III, section 2 (standing of plaintiff).

2. Title 28, United States Code section 1341.

III

STATEMENT OF THE CASE

Prefatory Statement

Petitioner has completely misstated a crucial fact in the opening sentence of its "Statement of the Case," when it states that the California State tax officials seek to assess a tax against plaintiff's subsidiary "on a portion of plaintiff's income." (Pet. for Cert., p. 3.) First, the proposed assessment was made by the Franchise Tax Board of the State of California and not by any of the named defendants. Second, the proposed assessment was an assessment against petitioner's subsidiary based on the unitary method of taxation and *not an assessment on a portion of plaintiff's income.*

This misstatement vividly demonstrates the complete lack of merit in petitioner's lawsuit.

Relevant Facts

Petitioner EMI, Limited (hereafter "EMI") is a British corporation which owns substantially all the stock of Capitol Industries-EMI, Inc. (hereafter "Capitol"), which is a domestic corporation doing business in California.

Franchise Tax Board (hereafter "FTB") is the agency of the State of California administering the income and franchise tax laws of that state.

The named defendants are members of the FTB and the executive officer of the FTB.

FTB assessed a tax against *Capitol, not EMI,* under the unitary method.

FTB assessed no tax, did not audit and took no action against EMI, which is outside the jurisdiction of FTB.

On August 15, 1979, EMI and Capitol filed separate lawsuits in the United States District Court for FTB for injunctive and declaratory relief to enjoin the named defendants from assessing a tax against Capitol.

On February 4, 1980, the District Court ordered the lawsuits of both EMI and Capitol dismissed by granting summary judgment to the named defendants; thereafter, both EMI and Capitol appealed to the Court of Appeals, Ninth Circuit.

On October 15, 1981, the Ninth Circuit Court of Appeals heard oral arguments in both lawsuits.

In the meantime, both prior to and during the federal court proceedings, and even at this very moment, Capitol continued to pursue state administrative proceedings to litigate the tax assessment. Even today, Capitol can still pay the tax, file a claim for refund and then file a suit for refund in the California state courts to litigate the issues EMI has raised in this lawsuit.

ARGUMENT

I

EMI HAS NO STANDING TO SUE UNDER ARTICLE III, U.S. CONSTITUTION

A. EMI's Rights Are Speculative and Uncertain

On the basis of the undisputed facts, it is clear that EMI has no standing to sue. The FTB has not assessed or sought to assess any tax against EMI, nor has it sought to take any action against EMI, which is a foreign corporation that does no business in the United States and is not a California taxpayer. EMI is only a shareholder of Capitol, the corporation which does business in California against which the FTB assessed a tax measured by the unitary method.

In spite of these undisputed facts, EMI has based its federal court standing on the speculative contention that as a shareholder of Capitol, it will suffer the possible loss of diminished dividend income. The premise of that contention is fallacious. It is obvious and common knowledge that the declaration of dividends is dependent on not earnings alone, but also on other corporate policy factors such as corporate expansion plans, need to build up cash reserves, etc.

EMI is a separate and independent entity from its subsidiary, Capitol, occupying the status of a separate shareholder. In that capacity, EMI has no absolute right to receive anything from Capitol. It certainly does not have the right to receive monthly, quarterly, annual or any other form of dividend. In fact, as a shareholder of Capitol, EMI owns neither the corporate property nor the corporate earnings of Capitol; it simply has an expectancy in each. This well-established proposition was stated by the United States Supreme Court in these words:

> "The owner of the shares of stock in a company is not the owner of the corporation's property. He has a right to his share in the earnings of the corporation, as they may be declared in dividends arising from the use of all its property. In the dissolution of the corporation he may take his proportionate share in what is left, after all the debts of the corporation have been paid and the assets are dividend in accordance with the law of its creation. But he does not own the corporate property." (*Rhode Island Hospital Trust Co. v. Doughton* (1926) 270 U.S. 69, 81.)

Therefore, in light of the nature of EMI's interest in Capitol, EMI cannot truly show any injury. Nor is an adjudication in this case necessary because Capitol will be the best proponent of its own rights regarding the applicability to it of the unitary method of taxation. Finally, there is no obstacle to Capitol asserting its right both administratively and judicially in California. In fact, Capitol is at this very moment proceeding administratively in California, concurrent with its companion lawsuit.[1] If it fails to prevail administratively, Capitol can pay the tax and file a suit for refund in the California courts.

B. The Most Recent United States Supreme Court Decisions Confirm That EMI Has No Standing

In the last few years there have been several major decisions involving the question of standing. However, in none of these cases has the United States Supreme Court expanded the standing doctrine to a person where that person, directly affected by some governmental action, has had a remedy in the state courts, or where that person was actually litigating the identical issues against the same defendant in the state courts.

In *Simon v. Eastern Ky. Welfare Rights Org.* (1976) 426 U.S. 26, several indigents and organizations brought suit against the Secretary of the Treasury and the Internal Revenue Service Commissioner, challenging a Revenue

1. *Capitol Industries-EMI, Inc. v. William M. Bennett, et al.*, 9th Circuit Number 80-4113, filed on the same date as this action.

Ruling which granted favorable tax treatment to a nonprofit hospital. The court rejected the challenge and set forth as a standing prerequisite the need for the plaintiff to show "an injury to himself that is likely to be redressed by a favorable decision." Here, not only is EMI's purported injury speculative, but there also is no assurance of redress. Even if this Court should rule that the unitary tax as applied to Capitol is unconstitutional, there is absolutely no assurance that Capitol will declare a larger dividend to EMI.

Furthermore, in a concurring opinion, Justice Stewart expressed the indisputable maxim of tax law as follows:

> "I add only that I cannot now imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else." (*Id.*, at p. 46.)

The next major standing case decided by the court was *Duke Power Co. v. Carolina Ev. Study Gp.* (1978) 438 U.S. 59, where the court extended standing to an environmental organization, a labor union and a number of residents near certain planned nuclear plants. It was not difficult for the court to find standing in *Duke Power* because the case involved "the question of whether Congress may, consistent with the Constitution, impose a limitation on liability for nuclear accidents resulting from the operation of private nuclear power plants licensed by the Federal Government." (*Id.*, at pp. 62-63.) There is no analogy between the interests of the various plaintiffs in *Duke Power,* where the threatened nuclear injury was pervasive and compensation for damages from injury would have been unconstitutionally circumscribed, and the interest of EMI, a foreign corporation, which seeks to overthrow the sovereign taxation power of the State of California.

Duke Power was followed by *Bryant v. Yellen* (1980) 447 U.S. 352, where the United States government filed a declaratory relief action to ascertain whether section 46 of a particular law applied to leased lands. There when the district court ruled against the United States, the latter did not appeal from the adverse decision. Therefore, certain persons intervened to press an appeal on their own behalf because that case was the only vehicle available to them to have the question of the applicability of section 46 determined. If section 46 applied, then the intervenors would have the possibility of purchasing certain lands. The court extended standing to the intervenors on appeal because if they prevailed on their contention that section 46 of the law applied, they would have the possibility of purchasing the land. On the other hand, if the adverse decision was not appealed by the intervenors in light of the United States government's failure to do so, the intervenors would never have the possibility of purchasing the land.

Obviously, the facts in *Bryant v. Yellen* are completely dissimilar from those in this lawsuit. Here Capitol not only is capable of asserting its legal rights in the state court, it has taken all the steps necessary to the filing of a suit for refund in California except for payment of the tax and filing a claim for refund.

Finally, *Maryland v. Louisiana* (1981) .... U.S. ...., 68 L.Ed.2d 576, is not only *sui generis*, it is fully distinguishable. There, various states sued the State of Louisiana requesting a declaration that Louisiana's "first-use" tax was unconstitutional. The Supreme Court accepted original jurisdiction and found that the plaintiff states had standing because:

> "The plaintiff States are substantial consumers of natural gas. . . . It is clear that the plaintiff States, as

> major purchasers of natural gas whose cost has increased as a direct result of Louisiana's imposition of the First-Use Tax, are directly affected in a 'substantial and real' way so as to justify their exercise of this Court's original jurisdiction." (*Id.*, at pp. 589-590.)

The court also went on to find a second and alternate basis for standing in these words:

> "Jurisdiction is also supported by the State's interest, as *parens patriae*. A State is not permitted to enter a controversy as a nominal party in order to forward the claims of individual citizens. [Citations.] But it may act as the representative of its citizens in original actions where the injury alleged affects the general population of a State in a substantial way." (*Id.*, at p. 590.)

The court then pointed out another factor favoring standing, namely, that "individual consumers . . . are foreclosed from suing for refund in Louisiana's courts." (*Id.*, at p. 591.) However, in the case of EMI, not only was the tax assessed against Capitol, the latter has proceeded administratively and is in a position to file a suit for refund after paying the tax. This case is similar to *Arizona v. New Mexico* (1976) 425 U.S. 794, 797, where the court refused federal standing and held:

> "[I]n the circumstances of this case, we are persuaded that the pending state-court action provides an appropriate forum in which the *issues* tendered here may be litigated." (Emphasis in original.)

In short, in none of the recent standing decisions has the court extended standing to a nontaxpayer to litigate the tax liability of the taxpayer. However, EMI is seeking to do precisely that in this lawsuit in the federal court. Thus, EMI has no standing in this lawsuit.

II

28 U.S.C. SECTION 1341 BARS ISSUANCE OF INJUNCTIVE AND DECLARATORY RELIEF

EMI apparently contends that merely because it cannot file a suit against the FTB in the California courts, a fortiori it can do so in the federal courts. EMI's conclusion is erroneous because there is no legally recognizable controversy between EMI and FTB.

As amply demonstrated by EMI's companion lawsuit, EMI is seeking to use this action to obtain jurisdiction in the federal court to destroy the unitary method of taxation which has received repeated approval by the United States and California Supreme Courts. (*Butler Bros. v. McColgan* (1942) 315 U.S. 501; *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n* (1924) 266 U.S. 271; *Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425, 62 L.Ed.2d 510; *Exxon Corp. v. Wisconsin Dept. of Revenue* (1980) 447 U.S. 207; *Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal.2d 406; *Chase Brass & Copper Co. v. Franchise Tax Board* (1970) 10 Cal.App.3d 496.)

There is no authority whatsoever for a non-taxpaying, foreign corporation that is not subject to California taxing jurisdiction to bring an action in the federal court to overthrow the sovereign taxing powers of the State of California.

The historic rule that the federal courts will not interfere with the internal fiscal operations of the states has been codified in 28 United States code section 1341:

> "The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that 28 United States Code section 1341 is an explicit congressional limitation on the jurisdic-

tion of the federal courts in cases which would enjoin, suspend or restrain state tax levy, assessment or collection. (*Randall v. Franchise Tax Board of the State of California* (9th Cir. 1971) 453 F.2d 381, 382; *Bland v. McHann* (5th Cir. 1972) 463 F.2d 21, 24, cert. denied, (1973) 410 U.S. 966.) Furthermore, neither the judicial decisions nor section 1341 require that the state remedy be the best remedy available or even equal to or better than the remedy which might be available in the federal courts. (*Id.*)

In this case, the lower court held that because the interests of EMI are identical with that of Capitol, and because the latter has speedy, efficient and proper remedies before the state administrative and judicial machinery, EMI's proper, speedy and efficient remedy is to have Capitol pay the tax, if any is ultimately assessed[2] against the latter, and then pursue an action in the state courts.

The California Revenue and Taxation Code provisions referred to below provide readily available and wholly effective administrative procedures for aggrieved taxpayers. Once these administrative remedies have been exhausted, the taxpayer can institute an action for a refund in the state court. This procedure has been consistently held, as a matter of law and without a single instance of deviation, to be plain, speedy and efficient as to invoke the restraints of 28 United States Code section 1341. (*Nevada-California Electric Corp. v. Corbett* (N.D. Cal. 1938) 22 F.Supp. 951; *Corbett v. Printers and Publishers Corp., Ltd.* (9th Cir. 1942) 127 F.2d 195, 197.) Moreover,

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2. Because Capitol has not yet exhausted its California administrative remedies, and administrative proceedings are still possible, the administrative proceedings ultimately may result in no additional taxes being due by Capitol. Then the entire lawsuit will be moot.

a taxpayer can further expedite the state administrative procedures by paying the tax, filing a claim for refund and waiting for six months, and then filing a suit for refund in the state court. (Rev. & Tax. Code, §§ 26073, 26074, 26075 and 26076.) Thus, this action should be dismissed for lack of jurisdiction. (*Bland v. McHann, supra,* 463 F.2d 21, cert. den., 410 U.S. 966.)

III

THERE IS NO EXPRESS TREATY PROHIBITION AGAINST UNITIZING FOREIGN OPERATIONS

EMI contends that the treaty provisions prohibit California from employing the unitary method to foreign unitary operations. But EMI has not pointed to any provision in any treaty that expressly prohibits such. Moreover, under the "savings" clause found in all United States tax treaties, the United States retains the right to tax its citizens, residents and corporations on the basis of their worldwide income as though the treaty had not come into effect.

In support of its policy speculations regarding possible foreign retaliations and its contentions regarding possible federal treaty violations, EMI has not cited one authority. Instead it has referred to correspondence and views of former officials of a former administration that was overwhelmingly ousted by the electorate in November 1980.

It is also interesting to note that EMI has failed to include in its exhibits pertinent materials which were released by the United States State Deparament and with which it is familiar, namely, the exchange of communications between the United States and Netherland governments and the preliminary draft of the Standard Treaty of Friendship, Commerce and Navigation.

Attached to this brief are FTB's Exhibits "A," "B," and "C," respectively, the letter of August 22, 1980 of the Department of State, the draft of the Standard Treaty of Friendship, Commerce and Navigation, and the September 18, 1979 note of the Netherlands Charge d' Affaires and the December 20, 1979 response of the United States Department of State. As is clearly evident from the United States' response, the Netherlands' complaint regarding the application by California of the unitary method of taxation to Shell Oil Company was rejected.

> "United States officials have examined this question in light of the facts as presented in the September 18 note, the provisions of the 1956 Treaty of Friendship, Commerce and Navigation between the United States and the Netherlands and generally accepted principles of international law. It is difficult to make factual judgments on these issues at such an early stage in their development, but, based on the facts as now presented by the Netherlands authorities, this Department is not in a position to conclude the practices complained of are inconsistent with either the standards set forth in the Treaty or general principles of international law."

In summary, EMI has not stated a single fact to demonstrate that FTB has violated EMI's purported rights under the United States Constitution or laws. Nor has EMI expressly pointed out even a single provision of any law purportedly violated by the FTB vis-a-vis EMI. Finally, EMI has not cited one case which supports its contention that FTB cannot assess a corporation doing business in California, viz., Capitol, under the unitary method. Thus, EMI's action is totally devoid of merit, and the petition should be denied.

IV

CALIFORNIA COURTS CAN AND ARE FULLY QUALIFIED TO DECIDE THE QUESTION OF THE CONSTITUTIONALITY OF THE UNITARY METHOD OF TAXATION AS APPLIED TO EMI'S UNITED STATES SUBSIDIARY

Even in this age of profligate lawsuits, this action by EMI is incredible. This is not an action involving any basic inalienable constitutional rights of a resident or citizen of the United States. Quite to the contrary. This is an action by a foreign corporation, which is not even subject to California jurisdiction, seeking to utilize the federal courts to judicially overthrow the sovereign taxation powers of the State of California.

If California's unitary method is as unconstitutional and illegal as EMI would have this Court believe, the California appellate and supreme courts would nullify it. After all, EMI has not furnished any evidence that the California courts are not capable of understanding the law. Nor is there any evidence that the California courts would not follow the laws as interpreted by the United States Supreme Court. Moreover, if Capitol does not have enough conviction to pursue its own direct rights in a lawsuit in the courts of the State of California, what reason is there for its shareholder, EMI, to pursue an action in the federal court in support of a speculative and indirect right?

EMI's suit is also disruptive of the entire judicial process. There are recognized principles regarding the subject of contesting state taxes. In addition, there is the proscription against multiple lawsuits. In this day when the public is clamoring for less taxes and greater government efficiency, responsible persons should seek to minimize litigation. This lawsuit completely violates these principles. There is not one valid reason for a nontaxpayer such as EMI to chal-

lenge a state tax imposed on a taxpayer when that taxpayer has an adequate and speedy remedy in the California courts. (*Aronoff v. Franchise Tax Board* (9th Cir. 1965) 348 F.2d 9.) Moreover, there will be utter chaos if every disgruntled non-taxpayer, or even taxpayer, sought to attack various state laws in the federal courts under the guise of some purported violation of a constitutional provision by which he is indirectly affected.

CONCLUSION

For the foregoing reasons, it is respectfully submitted this petition for writ of certiorari should be denied.

DATED: December 28, 1981

Respectfully submitted,

GEORGE DEUKMEJIAN
Attorney General of the
State of California

EDWARD P. HOLLINGSHEAD
Deputy Attorney General
CHARLES C. KOBAYASHI
Deputy Attorney General
Attorneys for Defendants

Exhibit "A"

Recd Aug 29 1980 Sat.

Received Sep 2 1980

Sacramento, Calif. Franchise Tax Board

Department of State

Washington, D.C. 20520

August 22, 1980

Mr. D.R. Milton
Vice President Tax
Shell Oil Company
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

Dear Mr. Milton:

Scott Gudgeon and I enjoyed meeting you, and found interesting the results of your own research and reflection on the standard FCN Treaty tax article.

As you requested, we have reviewed our FCN files on Article XI (maintained in connection with Mr. Sullivan's contract study), unitary taxes, and FCN annotations, and can make available all substantive documents pertaining to Article XI(4). These are described in the attached listing, and are enclosed.

In keeping with the usual practice of the Office of the Legal Adviser, we are providing this material also to tax counsel for the State of California.

The Office of Treaty Affairs is continuing to search for other documents you requested, and for a few documents to which reference was found in our files.

Very truly yours,

STUART E. BENSON
Stuart E. Benson
Acting, Assistant Legal Adviser
Office of the Legal Adviser

Enclosures:
As stated.

cc: Mr. Benjamin F. Miller
Franchise Tax Board
State of California

Documents Furnished:

1. Preliminary draft, FCN Annotation prepared under contract to the Department of State by Charles H. Sullivan, Article XI(4).
2. Annotated FCN for Portugal, undated (c. 1948), prepared by Herman Walker, Department of State, Article X.
3. Exchange of notes between Embassy of the Netherlands (Sept. 18, 1979) and the Department of State (Dec. 20, 1979) regarding Royal Dutch Shell complaint concerning California tax practices. Italian Embassy Note of March 19, 1980, on behalf of the EEC.
4. Memorandum to Embassy Rio de Janeiro and draft FCN text in relevant part (Instr. 7972), undated. (This document was declassified for release).
5. Explanation of US FCN Proposals (AER-type FCN text), A-80 of 4/20/56 (decontrolled for release).

6. Explanation of US FCN Proposals (same as preceding but for notations).
7. Explanation of US AER Proposals, Muscat, undated (concluded 1958).
8. Summary of AER provisions, undated (marginal note "1966").
9. Memorandum to Embassy Chungking, enclosed with Dept. Instr. 48 of 2/16/45.
10. HICOG Bonn Depatch No. 2255 of Feb. 17, 1954.

FCN: Treaty of Friendship, Commerce and Navigation
AER: Short-form FCN, Treaty of Amity and Economic Relations
August 22, 1980

Exhibit "B"

STANDARD DRAFT TREATY OF FRIENDSHIP, COMMERCE AND NAVIGATION

INTRODUCTION

This study of the standard draft treaty of friendship, commerce and navigation is in six parts, as follows:

1. The text of the standard draft treaty of friendship, commerce and navigation as of January 1, 1962, by which time the evolutionary development of the standard draft could be considered as complete. (Page 1)

2. A list of the treaties of friendship, commerce and navigation and related agreements that are currently in force. (Page 50)

3. Article-by-article, paragraph-by-paragraph annotations of the text of the standard draft treaty of friendship, commerce and navigation. (Page 59)

4. Comparative tables for each treaty of friendship, commerce and navigation or related agreement listing its provisions against the provisions of the standard draft and providing brief summaries of the principal variations between the individual treaty and the standard draft. (Page 336)

5. Summaries of court decisions since 1930 that involved consideration of the provisions of treaties of friendship, commerce and navigation or related agreements. (Page 453)

6. A selected bibliography of law review articles and other works relating to treaties of friendship, commerce and navigation of similar agreements. (Page 475)

This study was prepared by Charles H. Sullivan with major research assistance from Jonathan Blatt and George S. Cole.

Article XI

1. Nationals of either Party residing within the territories of the other Party, and nationals and companies of either Party engaged in trade or other gainful pursuit or in scientific, educational, religious or philanthropic activities within the territories of the other Party, shall not be subject to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, within the territories of such other Party, more burdensome than those borne by nationals and companies of such other Party.

2. With respect to nationals of either Party who are neither resident nor engaged in trade or other gainful pursuit within the territories of the other Party, and with respect to companies of either Party which are not engaged in trade or other gainful pursuit within the territories of the other Party, it shall be the aim of such other Party to apply in general the principle set forth in paragraph 1 of the present Article.

3. Nationals and companies of either Party shall in no case be subject, within the territories of the other Party, to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, more burdensome than those borne by nationals, residents and companies of any third country.

4. In the case of companies of either Party engaged in trade or other gainful pursuit within the territories of the other Party, and in the case of nationals of either Party engaged in trade or other gainful pursuit within the territories of the other Party but not resident therein, such other Party shall not impose or apply any tax, fee or charge upon any income, capital or other basis in excess of

that reasonably allocable or apportionable to its territories, nor grant deductions and exemptions less than those reasonable allocable or apportionable to its territories. A comparable rule shall apply also in the case of companies organized and operated exclusively for scientific, educational, religious or philanthropic purposes.

5. Each Party reserves the right to: (a) extend specific tax advantages on the basis of reciprocity; (b) accord special tax advantages by virtue of agreements for the avoidance of double taxation or the mutual protection of revenue; and (c) apply special provisions in extending advantages to its nationals and residents in connection with joint returns by husband and wife, and as to exemptions of a personal nature allowed to non-residents in connection with income and inheritance taxes.

Article XI, Paragraph 4: Territorial Limitation on Tax Basis

4. In the case of companies of either Party engaged in trade or other gainful pursuit within the territories of the other Party, and in the case of nationals of either Party engaged in trade or other gainful pursuit within the territories of the other Party but not resident therein, such other Party shall not impose or apply any tax, fee or charge upon any income, capital or other basis in excess of that reasonably[12] allocable[13] or apportionable[14] to its

12. This provision provides an elementary, although incomplete, safeguard against double taxation by stipulating that taxes shall be imposed on only that portion of a nonresident alien or alien corporation's income that is truly representative of the income or profits derived from operations within the taxing country. The intent is to prevent taxation of global income. It does not necessarily preclude taking into account the entire income, capital and property of an enterprise, wherever situated, as, for example, in determining the rate of tax. It does seek to prevent the ascertainment

those reasonably allocable or apportionable to its territories. A comparable rule shall apply also in the case of companies organized and[16] operated exclusively for scientific, educational, religious or philanthropic purposes.

---

or measurement of the tax base, to which such rate is to be applied, on the basis of what is outside the country.

13. The term "allocable" is considered as assigning or applying a share of total income on a percentage basis, which conceivably could be somewhat arbitrary and uneven in proportion.

14. The term "apportionable" is considered as implying an equal division among the various elements involved. The two terms, taken in conjunction, are intended to cover all the various methods, proportionate or otherwise, by which a reasonable tax base might be determined.

15. This provision is intended to ensure that the taxpayer in a multiple income situation is not to be denied deductions and exemptions normally allowable or granted less favorable ones but is to receive them commensurately with the governing principle of Article XI(4).

16. It should be noted that the company must be both organized and operated for the nonprofit purposes specified.

Exhibit "C"

P790148-2295
7 Oct 1979
Action is assigned to
L/EB 6031

The Charge d'Affaires a.i. of the Netherlands presents his compliments to the Honorable the Secretary of State and has the honor to request Mr. Vance's kind attention for the following matter.

The Authorities in the Netherlands have received a complaint by the Royal Dutch Shell Company with regard to certain practices of the Franchise Tax Board of the State of California (See Annex). An analysis of the complaint convinced the Netherlands Government that these practices indeed are contrary to the provisions of the Treaty of Friendship, Commerce and Navigation between the Netherlands and the United States of 1956 and to the accepted priniples of general international law.

It would be highly appreciated if the Secretary could have this matter investigated and inform the Charge d'Affaires a.i. on the results of his findings.

Encl.: 1

(Seal)
Received Department of State
1979 Oct 1 PM 1:40
FADRC Document Analysis

Washington, D.C.
September 18, 1979
Legal Adviser Oct. 1979
Department of State

ANNEX

I. *Complaints*

It is the conviction of the Netherlands Government that on account of the method of taxation by the State of California and the requirements imposed in connection therewith on the American corporations Shell Oil Company and Scallop Nuclear Inc. based on the "unity of business", assumed by the California Franchise Tax Board (FTB) to exist between the above mentioned corporations and the entire Royal Dutch/Shell Group, the Netherlands members of this Group, notably Royal Dutch Petroleum Corporation and Shell Petroleum NV, are treated in contravention with the provisions of the Treaty of Friendship, Commerce and Navigation between the Netherlands and the United States of 1956 as well as contrary to general international law.

II. *The Facts*

Shell Oil Company, a Delaware corporation, is owned for about 70% by Shell Petroleum NV, a Netherlands company; Scallop Nuclear Inc., also a Delaware corporation, is 100% owned by Shell Petroleum NV. Both Shell Oil and Scallop pursue certain activities in California and are assessed for the California Franchise Tax.

On the basis of the "unity of business" which the Franchise Tax Board (FTB) assumes to exist between Shell Oil and Scallop on the one hand and other companies of the Royal Dutch/Shell Group on the other hand, the first two companies are being assessed for that share of the worldwide profit of the Royal Dutch/Shell Group that, according to California legislation, in case of unity can be apportioned to them. Although Shell Oil denies unity with the other companies of the Royal Dutch/Shell Group, the FTB maintains that an integrated oil company is unitary by definition. The reasons for assuming unity between the

Royal Dutch/Shell Group and Scallop are unclear because Scallop is the only company of the Shell Group engaged in nuclear energy activities. The FTB asked Shell Oil for the purpose of unitary assesment information about all companies that are owned for 50% or more by the Group. This information which was not available to Shell Oil itself, concerned more than 900 companies; requested were inter alia the financial accounts of the entire Group over the years 1967-1972, to be presented in accordane with American financial standards and in dollar figures. If the information would not be deemed satisfactory by the FTB this would lead to the imposition of a 25% fine.

Only after Shell Oil would have provided the required information the FTB would be prepared to reconsider its assumption of unity or a revision of the assessment.

Further judicial recourse in the State of California or at the Federal level is not possible until after payment of the contested assessments.

III. *Incompatability with international law*

A. Treaty of Friendship, Commerce and Navigation between the Netherlands and the United States of 1956.

Under Article I, paragraph I, "Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party, and to their property, enterprises and other interests". The complaint of the Netherlands Government concerns the treatment by the State of California of Shell Oil Company, a Delaware corporation, of which more than 69% of the shares are owned by Shell Petroleum NV, a company incorporated under Netherlands law and established in the Netherlands, which in turn is a subsidiary holding company of the NV Koninklijke Nederlandse Petroleum Maatschappij (Royal Dutch

Petroleum Company), also a company incorporated under Netherlands law and established in the Netherlands; the complaint also concerns the treatment of Scallop Nuclear Inc., a Delaware corporation fully owned by Shell Petroleum NV. The Netherlands Government is of the opinion that both Scallop Nuclear Inc. and Shell Oil Company are to be considered a property or an enterprise of a Netherlands company.

It is the view of the Netherlands Government that the levying of taxes on Shell Oil Company and on Scallop Nuclear Inc. by the State of California on the basis of the California FTB's assumption of "unity of business" with the other companies of the Royal Dutch/Shell Group, is neither fair nor equitable.

The Netherlands Government does not want, nor is it in a position, to discuss the question whether according to Californian legislation "unity of business" indeed exists. It is, however, of the opinion that apportionment of the profit of the entire Royal Dutch/Shell Group in accordance with California legislation is in violation of the obligations resulting from Article I, paragraph I of the Treaty of Friendship, Commerce and Navigation of 1956. This opinion is based on the fact that California State law apportions to Shell Oil and Scallop profit which bears the same proportion to the profits of the entire Royal Dutch/Shell Group as the properties, sales and payroll of the said companies in California bear to the properties, sales and payroll of the entire Royal Dutch/Shell Group. The results of an apportionment of such a kind can only correspond with the profits actually made, when the effect of the above-mentioned factors on the profitability of a business is the same all over the world. While it might perhaps be assumed that for the entire territory of the United State this effect

is the same, it is an established fact that this does not apply to all areas in the world where the Royal Dutch/Shell Group is operating. Thus the apportionment of the profit of a corporation with worldwide activities on the basis of one single formula cannot be considered a fair and equitable treatment.

The Netherlands Government considers the unitary taxation of Shell Oil and Scallop by the State of California an unreasonable measure in contravention of Article IV, section 3 of the Treaty of Friendship, Commerce and Navigation of 1956, because unitary taxation and apportionment of profit on that basis are in contravention of the generally accepted principle that companies associated with companies in another country should be assessed in the country where their effective management is situated and only for the profit that they have actually made in that country, unless in the commercial or financial relations between the enterprises conditions are made or imposed which differ from those which would have been made between independent enterprises.

In OECD of which both the United States and the Netherlands are members, this principle which usually is referred to as "the arm's length principle" is generally accepted as the standard for the calculation of the taxable profit of associated enterprises (notably in Article 9 of the OECD Model Double Taxation Convention on Income and on Capital of 1977). Neither the Netherlands nor the United States have made any reservation in the acceptance of this standard. The United States have even declared that in their opinion the "arm's length standard" should not only apply to related enterprises but to all related persons and to all sources of income.

The Governments of the OECD memberstates, in their "Declaration of June 21, 1976, on International Investment

and Multinational Enterprises", have declared to be of the opinion that enterprises should refrain from making use of particular facilities available to them, such as transfer pricing which does not conform to an "arm's length standard" for modifying in ways contrary to national laws the tax base on which members of the Group are assessed.

The United Nations Expert Group on tax treaties between developed and developing countries also holds the opinion that the "arm's length standard" should apply to the calculation of taxable profit of related companies.

On all of the above mentioned occasions both the United States and the Netherlands have accepted the principle that related companies should be taxed on the basis of actual results unless the latter would deviate from results that would have been achieved if relations between the enterprises were based on an "arm's length standard". Unitary taxation as practised by the State of California obviously violates those principles.

The unreasonable character of the California tax legislation clearly shows in the case of Scallop Nuclear Inc. This company had suffered accumulated losses amounting to $390,000,000 by the end of 1976, whereas application of the California apportionment formula would lead to an opportionment to Scallop of a profit of $60,000,000.

The former Secretary of the Treasury, Mr. Blumenthal, also doubted the fairness and reasonableness of unitary taxation in his letter of July 10, 1977, to the California Franchise Tax Board, in which he stated:

"Though you state that unitary apportionment is the most accurate and reasonable method yet devised" for assessing the income of one element in a multinational Group, it is our experience, as well as that of most other countries, that the determination of income on the basis of an arm's length standard is not only accurate but also far

less arbitrary. The arm's length standard is the internationally accepted approach. Thus, in an international context, the use of another method by one jurisdiction will often lead to double taxation. The unitary system imposes a substantial compliance burden on multinational corporations. Much of the information required for a combined report with resp ·t to a foreign parent or foreign sister corporation may ot be available to the taxpayer. Even where the informa on is available the burden of reporting the accounts of mar · far-flung affiliates on a standardized basis can be great. We are aware of cases where this burden has discouraged foreign investment in the United States".

The afore mentioned arguments apply regardless the question whether there in fact is a "unity of business" between Shell Oil Company and Scallop Nuclear Inc. on the one hand and Shell Petroleum NV and the Royal Dutch/Shell Group on the other hand. If it would be assumed that the "unity of business" does indeed exist as stated by the FTB, taxation on the basis of apportionment according to California legislation is, in the opinion of the Netherlands Government, in contravention of Article XI, par. 4 of the Treaty of Friendship, Commerce and Navigation of 1956. This Article prohibits the States concerned to tax a company of one Party engaged in trade or other gainful pursuit within the territories of another Party, in excess of what is allocable or apportionable to its territories. As indicated above in the case of a company with worldwide activities, unitary apportionment can only accidentally lead to results that correspond with realty.

Therefore the Netherlands Government is of the opinion that unitary taxation cannot be considered a taxation of only that profit that is reasonably allocable to the State of California.

B. *General International Law*

The demands by the California Franchise Tax Board, through Shell Oil, for data that can only be supplied by the other companies of the Royal Dutch/Shell Group incorporated in foreign countries all over the world—and the imposition of a fine of 25% in case of non compliance—amount to a form of extra-territorial application of national legislation that is unacceptable to the Netherlands Government, because it contravenes well-established principles of international law. The California Board has no jurisdiction on this issue over the Netherlands companies Royal Dutch Petroleum Corporation and Shell Petroleum NV and it cannot lawfully compell them to supply the required data. International law, as evidenced by the general practice of States to date, does not permit a State to assume or exercise prescriptive jurisdiction over the conduct of an alien which occurs within the territory of another State or States solely on the basis that such conduct produces "effects" or repercussions within its territory.

The Secretary of State presents his compliments to His Excellency the Ambassador of the Netherlands and has the honor to acknowledge the receipt of the Embassy's note of September 18, 1979 concerning certain practices of the Franchise Tax Board of the State of California.

United States officials have examined this question in light of the facts as presented in the September 18 note, the provisions of the 1956 Treaty of Friendship, Commerce and Navigation between the United States and the Netherlands and generally accepted principles of international law. It is difficult to make factual judgments on these issues at such an early stage in their development, but, based on the facts as now presented by the Netherlands authorities, this Department is not in a position to conclude that the

practices complained of are inconsistent with either the standards set forth in the Treaty or general principles of international law.

United States officials believe, however, that these questions merit further examination and that certain practices of the Franchise Tax Board of the State of California raise, at the least, important issues of international tax and investment policy. Accordingly, the Department of State has contacted the California Franchise Tax Board to raise these concerns and has requested a meeting in order to fully examine these problems from an international legal and policy perspective. The Department will advise the Government of the Netherlands of the results of its discussions with authorities of the State of California upon their conclusion, at which time it hopes to be in a position to render the findings requested in the Embassy's note of September 18, 1979.

Department of State,
Wasington, December 20, 1979

Petitioner's Reply Brief

ALEXANDER L. STEVAS.
Office - Supreme Court, U.S.
FILED
JAN 18 1982
ALEXANDER L. STEVAS.
CLERK

No. 81-1088

IN THE SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1981

EMI LIMITED,

Petitioner,

vs.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR. Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and Martin HUFF and GERALD H. GOLDBERG, Successor,
Respondents

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

REPLY OF PETITIONER TO BRIEF IN OPPOSITION, AND SUPPLEMENTARY MEMORANDUM IN SUPPORT OF PETITION FOR CERTIORARI.

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TABLE OF AUTHORITIES CITED

None

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REPLY OF PETITIONER TO BRIEF IN OPPOSITION, AND SUPPLEMENTARY MEMORANDUM IN SUPPORT OF PETITION FOR CERTIORARI.

1. Two developments subsequent to the filing of the petition for certiorari should be called to the Court's attention. The first one is the Memorandum for the United States as Amicus Curiae, filed on January 12, 1982 by the Solicitor General in No. 81-349, Chicago Bridge & Iron Company, Appellant v. Caterpillar Tractor Co., Illinois Department

of Revenue et al., Appellees. In that Memorandum the Solicitor General endorsed views which we consider to be the same as we expressed in our petition for certiorari, and in the two courts below. Near the end of that Memorandum, the Solicitor General indicates that he is unaware of our petition for certiorari in the EMI Limited case, and suggests that the Court might wish to defer consideration of the issues argued in the Chicago Bridge & Iron case until a case such as EMI Limited v. Bennett actually appears before this Court. Thus, the Solicitor General stated:

> "It may well be that the multiple tax burdens and the impairment to federal uniformity in international trade caused by the state apportionment method will be more easily demonstrated in a case involving a corporate group with a foreign parent."

This is that case.

The second development is the filing with the Department of State by the Ambassador of the United Kingdom on December 17, 1981, of a letter presenting the criticisms by both the British Government and the Commission of the European Economic Community of the state unitary method involved both in the Illinois case and in this case. That letter is attached to the Memorandum Amicus of the United States. It was filed with the Department of State after the petition in this case was filed with this Court, and while preceding communications between the British Government and the Department of State and the Commission of the European Economic Community and the Department of State were set forth in the appendix to the petition for certiorari in this case, obviously the letter not yet written was not included. It is set forth in the Appendix to the Solicitor General's Memorandum Amicus, referred to above. It

states again what the documents in the appendix to this petition have stated, that these foreign governments object to the states' applying the combined unitary tax system to the corporations formed under the laws of those countries which have subsidiaries operating in the United States. The Solicitor General endorses those views, states the constitutional arguments supporting them, and urges the Court both to consider them and adopt them. That consideration can best be given in a case such as this case, as the Solicitor General's memorandum states.

2. Respondent's brief in opposition seeks to make it appear that the statements of Assistant Secretary of the Treasury Woodworth and Assistant Secretary of the Treasury Lubick, and Secretary of the Treasury Blumenthal, were merely the views of the administration in which they held office, and were not the views of the Government of the United States. The Memorandum of the Solicitor General, for the succeeding and current administration, adopts the same views, and demonstrates that the views of the United States Government are continuing, and do not sway with the breeze of political climate.

3. The jurisdictional argument made by respondents here for the first time, that EMI Limited has no standing to sue, need not detain the Court long. Part of it is sheer casuistry. Respondent's entire case on the merits is based on a disregard of the corporate entity, which in their eyes justifies the attribution to Capitol Industries-EMI Inc., and its California operations, of a portion of the income of a separate corporate entity, that of petitioner EMI Limited. No contention would be made by respondents or anyone else that if the commercial relationship in question were still that between EMI Limited and RCA, as it was prior to 1956, there would be any basis for the combined

apportionment that has occurred here, because there is not common ultimate beneficial ownership. What is being done by defendants is the disregard of separate corporate entities and the apportionment of income between nations based on the treatment of the income and assets of EMI Limited as belonging to the subsidiary, Capitol Industries-EMI Inc. Yet in the same breath respondents urge this Court to treat EMI Limited as a separate corporate entity having no stake in the income and assets of Capitol Industries-EMI Inc., and hence without standing to complain of that taxation of its income to Capitol! We are certain that the court will not endorse both inconsistent views simultaneously.

Petitioner's view does not deny the right of governments to disregard the corporate entities of subsidiary corporations and parent corporations, in proper cases. Petitioners complaint is that income that does not arise in the United States and has no genesis in California is being taxed by California, and, to make matters worse in petitioner's eyes, it is income fully taxed by the United Kingdom and other countries whence it arises, and which California would tax in full a second time, as if it were the primary sovereign nation. As the memorandum of the Solicitor General so well points out, that state attitude undermines the sovereignty of the United States, and its ability to speak with one uniform voice for the fifty componential political subdivisions embraced within it, both for them individually and for the complex representing the nation.

EMI's standing to sue is not dependent upon disregarding the corporate entity. EMI owns substantially all of the stock of Capitol Industries-EMI Inc., and EMI's asset, that stock, is reduced in value when the assets of Capitol Industries-EMI Inc. are threatened to be seized by respondents for payment of a tax on EMI's income. EMI is injured both directly

and indirectly, and indirectly has been made the subject of respondents' attack, and directly has been made to pay the burden of that attack through diminution of the value of its investment. The statement by respondents that EMI's right to dividends from Capitol Industries is only an expectancy is a red herring, because EMI has not complained of its dividends being reduced, but of its investment and asset being reduced in value. Also, EMI has complained that it should not be made to divulge to the State of California, its secrets which it is prevented by British law from revealing to foreign powers, and that it should not be made to attempt to develop information for California's benefit which it does not obtain for itself, and which its subsidiaries have never been asked to supply it for British purposes, for United States purposes, or for the purposes of complying with the laws of the many countries in which those subsidiaries operate. When California asked EMI to produce information which it believes it may not produce without violating the Official Secrets Act of the United Kingdom, and when respondents asserted tax against Capitol Industries based upon their estimate of the information EMI would produce if it could legally do so, EMI is given standing to sue in order that it may comply with the laws to which it is subject, without penalty by the State of California and its officials.

Respondents' contention that the State courts are the proper place to litigate the meaning of international law and of the United States - United Kingdom Income Tax Convention, the United States Constitution, and some other federal and international issues and considerations, is hollow. Those issues will ultimately be determined in this Court, not in the state courts, which have no jurisdiction to determine them finally. It is worthy of note that respondents have said

nothing to suggest that they do not mean to impose the tax of which EMI complains.

4. It is also notable that respondents have not disputed petitioner's contention that California law provides petitioner no remedy in the state courts, of any sort, and in any manner. Respondents merely repeat what the trial judge held, erroneously, that EMI Limited should be satisfied with the remedy which Capitol Industries-EMI Inc. has in the California courts. This position is being taken, with all seriousness, by the same state officers who argue elsewhere in their brief in opposition that EMI has no standing to sue because it is a separate corporation from Capitol. The correct answer to the position taken by the district judge and by respondents is that EMI Limited, a corporation of the United Kingdom, cannot be denied access to some American court, and Congress could not have intended to deny access to the federal courts to a foreign litigant which is denied access to the state courts. Moreover, as we have demonstrated in our petition in the companion case involving Capitol Industries-EMI Inc., No. 81-1177, the remedy the state courts afford Capitol Industries-EMI Inc. is not complete, is not adequate, and is highly suspect at best.

CONCLUSION

If the Memorandum of the Solicitor General in the Chicago Bridge & Iron case, No. 81-349, is read in conjunction with EMI Limited petition for certiorari, we believe the Court will conclude that the EMI Limited case presents the proper vehicle for consideration of the issues discussed in the Solicitor General's Memorandum and in our brief, and that the Court will wish to grant certiorari in the EMI Limited case, and possibly also in the companion case of Capitol Industries-EMI Inc., No. 81-1177, in order to provide the proper vehicle for

determination of these important constitutional questions. These state actions have so upset our major foreign trading partners that they have made protested to the Department of State. Petitioner EMI Limited is present in this Court, protesting what they protest, and it is EMI Limited's investment in California which respondents seek to hold hostage for their view that California may with impunity flout the settled international practice of allocating income between nations on the arms length, fair price method.

Respectfully submitted.

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